

Performance Based Payments



Presented by

Timothy Frank

Contract Financing and Payment Group

Defense Contract Management Command

tfrank@dcmcchq.dla.mil

Performance Based Payments

Performance Based Payments are part of the acquisition reforms of FASA, shifting the basis for contract financing from incurring costs to performance.

Performance Based Payments vs. Progress Payments

	<u>Progress Payments</u>	<u>Performance-Based Payments</u>
Order of Preference	Considered Customary contract financing	Preferred over other forms of customary financing
Approval level	CO	CO
Criteria for Use	>\$1M contract (large bus.)	Agreement on terms
Basis for Payment	PP Rate times Eligible Incurred costs (based on actual costs)	Up to 90% of contract price/delivery item price (based on predetermined amounts NOT actuals)
Entitlement to Payment	Approved payment request	Successful completion of performance event
Profit	Excluded from payment	Some profit may be excluded
Combining Financing	Stand alone (may be supplemented with advance payments/guaranteed loans	Stand alone (may be supplements with advance payments/guaranteed loans
Contract Type	Fixed Price	Fixed Price
Accounting System	Must be Approved	Does not require approval Note: FPIF contract still requires cost tracking
Frequency of Payment	Not more than monthly	Not more than monthly (may have >1 event per month)
Recoverable in Default	Yes	Yes
Alternate Liquidation Rate Applicable	Yes, under certain circumstances	No

Performance Based Payments

What are they?

- Contract Financing Payments based on contractor performance of definitive criteria uniquely established in each contract
- The preferred method of Contract Financing
- Fully recoverable in the case of default

Performance Based Payments

■ When Can They Be Used

- Definitized Fixed Price Non-Commercial Contracts
- When the Contracting Officer finds them practical
- When the Contractor agrees to their use

■ When Can't They Be Used

- In conjunction with Progress Payments
- Sealed bids
- Contracts for Research & Development
- Contracts for architect-engineer services, construction or shipbuilding

Performance Based Payments

When would you want to use them?

When the product and the processes required to deliver the product are *fully understood* by all the parties, such as follow on production contracts

Performance Based Payments

Why would you want to use them?

■ Government

- Payment only for performance
- Can be structured to motivate improvement
- Potentially easier to administer

■ Contractor

- Higher ceiling (90% of Price vs 75% Costs)
- PBPs provide better cash flow when contract is ahead of schedule, underrun or overrun
- PBPs do not require an approved accounting system or compliance with MMAS

Performance Based Payments

How do you establish Performance Events/Criteria?

PBP terms are part of the total negotiation of a fair and reasonable contract price

- **Payments may be based on**
 - Performance measured by objective, quantifiable methods
 - Accomplishment of defined events
 - Other quantifiable measures of results
- **Payment amounts may be established on any rational basis including**
 - Engineering estimates of stages of completion
 - Engineering estimates of hours or other measure of effort
 - Estimated projected costs of performance
- **Events may be severable or cumulative**

Performance Based Payments

How is a payment processed?

- The contractor presents request for payment to the ACO, no more than monthly, for all performance events completed in the period. The request will contain all required supporting documentation and will be certified by the contractor.
- The ACO verifies completion of performance events, approves request for payment, and forwards the request to the payment office.
- Payment office processes payment PBP's are financing payments for purposes of the Prompt Payment Act

Performance Based Payments

What happens if

- **There is Government Caused Delay?**

The contracting officer may renegotiate the PBP terms

- **There is a modification to the contract?**

The PBP terms may have to be changed by the contracting officer negotiating the change

- **The contractor fails to make progress, financial condition deteriorates, or doesn't pay his vendors?**

Performance Based Payments can be reduced or suspended for these reasons

Performance Based Payments

How is surveillance performed?

- **The ACO is responsible for determining what reviews are required based on assessment of Government Risk**
- **Reviews will include:**
 - Verification of performance events
 - Assessment of financial condition
 - Evaluation of progress on the contract
- **Use of a surveillance team incorporating appropriate technical specialist is encouraged**

Performance Based Payments

What has the experience been on PBPs?

The good: So far, no litigation, no defaults, no bankruptcies, no fraud
PBPs have been used to improve contractor performance

The bad: Some problems when...

- PBP criteria did not match how the product was actually being produced
- Overly strict or financially conservative criteria can negatively impact contractors ability to perform
- Too many performance events dilute motivational value, and increase the administrative burden

The ugly:

- Some PBP contracts are front loaded, virtually advance payments

Performance Based Payments

Some lessons learned

Performance Events

“Performance events must be “integral and necessary part of contract performance”

Examples of bad events:

- “Definitization of Contract F12345-99-C-0002: This event is successfully completed upon contractor signature” FAR 32.1004 prohibits using signing of contracts or modifications as performance events.
- “Initiate testing of avionics software” Meaning of “initiate not clear; no criteria for accomplishment.
- “Fabrication complete for forward fuselage; 100,000 hours charged to work order 387 as verified by DCMC.” Completion of time does not mean job is complete.
- “Six months prior to delivery” Completion of time does not constitute performance.
- “Attendance at Management System Review” Does this show true progress?

Performance Based Payments

Some Lessons Learned

Payment Amounts

“...financing shall be provided only to the extent actually needed for prompt and efficient performance” FAR 32.104(a)

Tips on PBP amounts:

- Limit amounts to contractor's actual financing needs
 - Obtain expenditure forecasts from the contractor
- Don't use PBP amounts to “induce performance that exceeds the contract requirements”
 - Increases risk to the Government
 - Remember, contractor is already getting 90% of price

Performance Based Payments

Some Lessons Learned

Tangible Value

“...avoid any undue risk of monetary loss to the Government through the financing.” FAR 32.104(a)

“ ...negotiate PBPs that establish payment amounts not expected to exceed the projected tangible value of that property.” (DDP memorandum Nov 9, 1998)

Tips on PBP amounts:

- PBPs are secured by title to the work in process
- Need to ensure that amounts are limited to contractor's actual financing needs
- Don't try to “incentivize” contractor with payments (another term for advance payments)
 - We do that with PBP structure, and the 90% rate
 - Increases risk to the Government

Performance Based Payments

A Successful PBP Contract

NAVAIR Contract N00019-97-C-0114, for 118 Aircraft Engines

It works because...

- Product and processes were well understood by all the parties
- Performance events are limited to 7 events per engine
- Performance events are clear and understandable, and *integral and necessary part of contract performance*
 - e.g. “Receipt of Vane Casting for LPT Nozzle Segment”
- Performance verification is clear:
 - e.g. “Casting received by GE and documented in IMPACT System”

Performance Based Payments

DCMC Early CAS significantly reduces risk

- DCMC pre-award support available to you includes...
 - ACOs and Technical Specialists review events, terms and conditions, to ensure they are understood, measure the right things, and reflect actual, significant progress
 - Technical Specialists review performance criteria to ensure they are clear and verifiable
 - Financial analysts/ DCAA review performance payment amounts, ensure they reflect contractor funding requirements, and *aren't advance payments*

Supports Alpha Contracting

Performance Based Payments

More Lessons Learned...

DCMC Early CAS assistance reduces risk

DCMC pre-award support available to you includes...

- ACOs and Technical Specialists review events, and terms and conditions, to ensure they are understood, measure the right things, and reflect actual, significant progress
- Technical Specialists review performance criteria to ensure they are clear and verifiable
- Financial analysts/with DCAA review performance payment amounts to ensure they reflect contractor funding requirements, and *are not advance payments*

Performance Based Payments

For more information, visit our web site...

http://www.dcmc.hq.dla.mil/Dcmc_o/cbo/finance/pbpay.htm

Or contact me:

Tim Frank

Contract Financing and Payment Group

Defense Contract Management Command

(703) 781-2615

tfrank@dcmchq.dla.mil